United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

75-5006

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P/S

United States Court of Appeals
FOR THE SECOND CIRCUIT

In the Matter
of
AMERICAN EXPRESS WAREHOUSING, LTD.,
Debtor.

REPLY BRIEF OF APPELLANT AMERICAN EXPRESS WAREHOUSING, LTD., DEBTOR

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Preliminary Statement

From Appellees' characterization of the position taken by the Debtor and its counsel with respect to the application of the Official Creditors Committee ("OCC") for attorneys fees, it appears that they have either never understood such position or have chosen to misstate it to suit their purposes on the application below and this appeal. No other conclusion can be drawn from such sweeping statements as: "In summary, the Debtor unjustifiably failed to oppose the application of the OCC, an application which Judge Ryan recognized clearly had no legal support * * *." (Appellees' Brief, page 7.) But what the Record herein and our main brief shows is that the Debtor and its counsel acted carefully and responsibly in a rather unique set of circumstances disclosed in the application itself and where there was every assurance that, notwithstanding the Debtor's neutrality, the court would be fully briefed on the principles of law and equity involved by the OCC's counsel and Appellees' counsel. After careful evaluation of the issues raised by the OCC application, particularly its effect

on distributions to the creditor group, Scarburgh's opposition thereto, the equities involved, and after careful review of the state of the law at that time (March, 1974), it was counsel's conclusion that there was not clear support in statute, case law and principles of equity for either granting or denying the application.

In their rather desperate attempt to meet the "special circumstances" test discussed by this Court in the case of *In re Sapphire Steamship Lines, Inc.*, 509 F.2d 1242 (2d Cir. 1975), Appellees have unfairly broadcast serious charges (Appellees' Brief, page 8) of failure of duty on the part of the Debtor, its counsel and the OCC and its counsel (the latter not being parties to this appeal). We submit, and argue *infra*, that there was no such failure on the part of the Debtor or its counsel. We also believed in March 1974 when the OCC's application was made, and believe now, that such application was conscientiously presented, with full treatment and discussion of the available body of pertinent law for Judge Ryan's benefit. See particularly the OCC's Memorandum J. 101a-J. 113a. Perhaps the best evidence that the decision to grant or deny the application was not as clear-cut as the Appellees contend is the fact that Judge Ryan, with his years of extensive experience in bankruptcy matters, first announced that he would grant the application (J. 140a, 141a, 151a) and then, after more than two months of deliberation and review of the papers, denied the OCC's petition on a strict application of *Lane* v. *Haytian Corporation of America*, 117 F.2d 216 (2d Cir.), *cert denied*, 313 U.S. 580 (1941). While the OCC did not appeal, to the date of this writing it is by no means clear to us that Judge Ryan's ultimate decision was correct. Whether this Court, on an appeal, would have favored the equitable considerations advanced by the OCC or the strict and technical application of the *Lane* rule advocated by Appellees and accepted by Judge Ryan will, perhaps, never be known and

may not be important. What is important is that the fair contest between the OCC and Scarburgh, and the role of Debtor and its counsel in relation to it, not be misdescribed in order to secure advantage for Scarburgh and its counsel on this appeal.

ARGUMENT

Appellees' brief has failed to demonstrate that Dunnington's application met the threefold *Sapphire* test.

1. The Debtor did not refuse or fail to act.

Appellees take great comfort from Judge Ryan's dicta, in granting Dunnington's application, to the effect that counsel for the Debtor should have opposed the OCC application in the first instance, presumably because the applicable bankruptcy law was clear. With the greatest respect for Judge Ryan, we respectfully submit that, while the holdings of the cases cited in his opinion (*Lane*, et al., J. 156a-157a) are reasonably clear in relation to their precise facts, the application of these cases to the facts presented in the subject application was far from clear in March 1974. The application, and Scarburgh's objections thereto, presented a number of circumstances which distinguished the application from the routine:

> (a) Any allowance granted would be immediately distributed to those creditors who had contributed to the interim financial support of the OCC, producing the effect of a sharing of such expenses *pro rata* by all creditors (J. 31a-32a, 34a and 104a);
>
> (b) The OCC activities in connection with which the legal services were rendered were beneficial to the Debtor's estate and thus to all creditors (which incidentally Appellees have never challenged by any factual showing but rather by insinuation that only

the large creditors benefited, as to which there is no evidence*);

(c) Scarburgh, as a substantial creditor which was a minor contributor to the OCC's legal expenses, "had an axe to grind" and a benefit to be achieved for itself since denial would mean a larger distribution to it and creditors similarly situated, while imposing almost the entire cost of the OCC's legal services in this complex arrangement proceeding on other creditors.

Being satisfied that neither side of this dispute had a monopoly of meritorious arguments, and that fairness to all creditors required not taking sides, the Debtor on the advice of its counsel did just that. In leaving the field to the contestants, we also felt assured that the court would have the law fairly presented to it. In short, the usual process by which, in our jurisprudence, the law is declared in relation to a particular set of facts was about to take place in the usual way. To liken this to a situation in which a trustee fails to oppose an application because it is his own *In re New York Investors,* 130 F.2d (2d Cir. 1942), cited by Judge Ryan (J. 221a) is to fail to discern the obvious differences presented here.

The Appellees' assertion that Rule 11-29 of the Bankruptcy Rules (effective July 1, 1974) bars a member (including an attorney member) of a creditors committee from receiving compensation for services rendered by him, Appellees' Brief at page 6, should gain them nothing on this appeal. Their further assertion that "compensation to members of creditors committees is disallowed to prevent large creditors from obtaining preferences by appointing

*The alleged testimony of Dr. Abraham Feinstein was not evidence, but merely the product of Judge Ryan's tolerance, since Dr. Feinstein's company, Amertrade, Inc., had assigned its entire claim to other creditors. *See* Order of Subrogation entered by Judge Ryan, 63 B 1021, dated June 9, 1967.

themselves or their counsel to the OCC" (Appellees' Brief at page 6) is accurate as far as it goes; nevertheless, several important points about new Rule 11-29 are not mentioned. The Order of the Supreme Court of the United States promulgating Chapter XI Rules, 415 U.S. 1005 (1974), states in paragraph 2:

> "[T]he . . . Chapter XI Rules . . . shall take effect on July 1, 1974, and shall be applicable to proceedings then pending except to the extent that *in the opinion of the court their application in a particular proceeding then pending would not be feasible or would work injustice, in which event the former procedure applies.*" [Emphasis added].

The decision of Judge Ryan was entered June 6, 1974, before the effective date of the rule cited by the Appellees. Secondly, even if this Rule were to apply, the Court, in the exercise of discretion and so as not to work an injustice, can avoid the application of this Rule and revert to the former rule—the very procedure under which the OCC application was made (J. 105a). Finally, at the time of the OCC application the latest word on the issue of counsel fees paid out of the assets of the Debtor's estate in the Southern District of New York was *In re Sapphire Steamship Lines, Inc.*, 373 F. Supp. 727 (S.D.N.Y. 1974) where counsel fees were granted to counsel for two creditors who had rendered services which provided a benefit to the class of creditors. The underlying rationale was that all who received a benefit should share the expenses in achieving that benefit. Concededly this Court reversed Judge Pollack's decision. *In re Sapphire Steamship Lines, Inc.*, 509 F.2d 1242 (2d Cir. 1975). However, counsel for the Debtor did not have the benefit of this Court's reasoning in the *Sapphire* case at the time this application was presented.

Appellees insist that the OCC's application was an attempt by certain creditors to gain an "illegal preference" which created a duty in the Debtor's counsel to act. This argument assumes that such counsel should have immediately concluded that there were no arguments or equities which could have persuaded the Court to grant the application. It also ignores counsel's perception that what was at stake was distributions to creditors, not a diminution of the distributable estate. (Appellant's Main Brief, page 5.) The real issue in the application was whether all creditors should bear the expense of the substantial benefits inuring to the Debtor's estate by the work of the OCC's lawyers. Notwithstanding *Lane* v. *Haytian Corporation of America,* 117 F.2d, *cert. denied,* 313 U.S. 580 (1941) and its progeny, there seemed to be a substantial possibility that the application would not be considered an occasion of preference if, as the OCC argued, such cases were distinguishable and weakened by criticism of their inflexibility (J. 106a). And where, as here, the bases for the application cited by the OCC were primarily equitable (J. 104a-112a), Debtor's counsel was also mindful that it was the Court, not counsel, which was peculiarly suited to weigh such matters. Accordingly there was a sound and reasonable basis for the position taken by Debtor's counsel: to allow the disputing creditors within the creditor group to plead and argue the substantial issue of whether equity dictated pro-rata apportionment of the expenses which brought about benefits for all or whether *Lane* standard be strictly applied.*

The final paragraph of Point I of Appellees' Brief at page 7, that the taking of a neutral position by Debtor's

*It is ironic to note that if the OCC had retained other law firms to perform the services which were performed by the law firms of the OCC members there would appear to have been no basis for the Appellees' opposition to an application to pay for such services. We submit this suggests that the original Scarburgh opposition was to secure advantage to Scarburgh based on a technical argument which exalted form over substance.

Counsel is "tantamount to claiming the debtor had no duty to conserve the estate," assumes that opposition to the OCC application was the only tenable position. But conservation of the estate was not the issue. Equitable distribution of the Debtor's remaining assets was the issue and there were fair arguments on both sides. The Debtor did its duty by remaining neutral.

2. The services of Dunnington benefited only its client, Scarburgh Company, Inc., and provided no benefit to the estate.

The Appellees incorrectly characterize their successful opposition of the OCC petition as benefiting the Debtor estate. The opposition by Dunnington was on behalf of and benefited only its client Scarburgh, and, quite incidentally, other creditors who had not proportionately contributed to the attorneys' fees of the OCC but shared in the benefits derived from its effective work. This was not the case of exorbitant fes being sought by a trustee as in *New York Investors*, 130 F.2d 90 (2d Cir. 1942); nor was it a case of a creditor seeking a larger share of the Debtor estate by seeking compensation for one of its officers or agents on a creditors committee—a preference, as the Appellees use the phrase. It was essentially a question of whether the disproportionate contributions of several creditors to the interim financing of a basic element of expense normally associated with bankrupt estates—legal services for a creditors committee—should be factored into the distribution of the Debtor's estate. Concededly such interim financing by creditors was unusual. But this was not a typical Chapter XI proceeding, as the Chairman of the OCC pointed out (J. 103a-104a).

The relative contributions of the members of the so-called "Scarburgh Group" make the point clear. Scarburgh held more than $3,000,000 in allowed claims, or ap-

proximately 12% of the claims of the Scarburgh Group. However, it contributed less than .9% (183,390 ÷ 1,759) of the total contributions to the OCC. (J. 59a-60a and Brief of Appellee, second footnote at page 3.) Such footnote shows that if any creditor was seeking a preference it would appear to have been Scarburgh in relation to other members of its creditor group. Its opposition brought about a situation in which the other members of that group have borne substantial portions of the OCC legal expense without reimbursement. On the argument of the OCC application, Scarburgh's counsel candidly admitted Scarburgh's motivation and explained why the strict application of the *Lane* doctrine would benefit his client as opposed to its bank creditors (J. 147a). Of course, such argument totally ignored any element of fairness or equity to those bank creditors derivable from the fact that the legal services to which they contributed appeared to have benefited all creditors, including Scarburgh.

3. There are no special circumstances to justify the payment of legal fees to Dunnington in the absence of Court appointment.

To equate the facts of *In re New York Investors,* 130 F.2d 90 (2d Cir. 1942) to those present here (Appellees' Brief, page 8) is to ignore the clearcut difference. In *New York Investors* counsel for one of the creditors was opposing an obvious raid on the Debtor estate in the form of an exorbitant claim for an allowance by the Trustee. Such was not the case here. By its application the OCC purported to show that its lawyer members and their firms had made major contributions to benefit all creditors, not just those they represented by, among other things, aiding in the marshalling of substantial assets for general distribution. Whether those assets would be charged with a reasonable allowance for such services was a basic question

presented here. Why the Debtor would not either oppose or support has already been made clear. But unlike the opposing creditor's counsel in *New York Investors,* who in protecting his client's interest protected the estate and other creditors, Scarburgh's counsel concededly and, lest there be any doubt, quite properly acted to secure a particular advantage for its client without regard to the effect of their action on the equitable position of other creditors. Having succeeded, they must be content with their success and remuneration from their client; for in aiding their client, they produced no recognizable benefit for *all* creditors which would, in these circumstances, excuse their lack of court appointment. *In re Sapphire Steamship Lines,* 509 F.2d 1242, 1246 (1975).

CONCLUSION

The order below should be reversed.

Respectfully submitted,

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AFFIDAVIT OF SERVICE

John G. Whelley, Jr., first being duly sworn, deposes and says that:

1. That he is at least eighteen (18) years of age;

2. He is not a party to the above encaptioned matter; and

3. He has this 15th day of August, 1975 served upon Dunnington, Bartholow & Miller, Attorneys for Appellees, Dunnington, Bartholow & Miller and Scarburgh Company, Inc. Two (2) copies of the Reply Brief of the Appellant, American Express Warehousing, Ltd., Debtor by mailing first class postage pre-paid to 161 East 42nd Street, New York, New York 10017.

John G. Whelley, Jr.

Subscribed and sworn to
before me this 15th day
of August, 1975.

Karen W. Michelson
Notary Public

KAREN W. MICHELSON
Notary Public, State of New York
No. 31-4514262
Qualified in New York County
Commission Expires March 30, 1977